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GENEVA FOR USTR

STATE FOR EB/TPP/BTA AND WHA/CAN - P.NORMAN

DEPT PASS USTR FOR J.MELLE AND S.CHANDLER

USDOC FOR 4320/MAC/WH/ON/OIA/BENDER

USDOC PASS ITC - JENNINGS

TREASURY FOR OASIA/IMI - MATHIEU

E.O. 12958: N/A

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SUBJECT: THE WORLD'S TOP TRADING PARTNERSHIP
IN THE MILLENNIUM TRADE SLUMP

SUMMARY

1. U.S. and world trade have declined significantly in the past two years from their peaks in 2000. This decline is an unusual event which is partly explained by the technology/telecoms crash. The world's largest bilateral trading relationship has been affected, with the value of trade declining some seven percent over two years - a sharp break from the performance throughout the 1990's. Canada's oil and gas exports to the United States have remained near the very high levels achieved in 2000 (after several years of impressive growth), limiting the size of the tech-driven slump. Canada's imports of pharmaceuticals grew by 90 percent in the past four years, an expansion which cannot be explained by domestic demand. END SUMMARY

SPIKE-SLUMP PATTERN LAST SEEN IN EARLY 80'S

2. While year-on-year declines in the value of U.S. merchandise trade have been rare in recent decades, our country's total trade fell by more than 7 percent over the past two years, and exports fell by more than 11 percent. The only comparable experience since 1960 was the period of major rust-belt restructuring in the early 1980's (exports in 1984 were 15 percent below their 1982 level). Both of these export slumps were preceded by export "spikes," in which U.S. worldwide exports briefly grew by two to three times their trend growth rate.

A BREAK IN THE FTA SUCCESS STORY?

3. U.S.-Canada trade - the world's largest two-way trading relationship - has followed this worldwide pattern in recent years. The value of bilateral merchandise trade jumped by 11.5 percent in 2000 over 1999, capping a decade of exceptional growth prompted by the 1989 FTA and the 1994 NAFTA. Then, from 2000 to 2002, it contracted by 7 percent - about the same percentage as U.S. worldwide trade.

4. This fundamentally changes the economic environment for this post, which (like our GOC contacts) had grown used to boasting about our terrific continental trade performance. We cannot blame weakness in Canada's economy, which has outgrown the U.S. each year since 1998 (averaging 3.7 percent in annual real growth versus 2.6 for the U.S). And trade in services, while strong, cannot make up for weakness in the much larger merchandise sector.

ENERGY, AUTOS HAVE HELD UP; TECH AND TRUCKS ARE HURTING

5. We cannot explain the causes, or predict the consequences, of the "millennium trade bust." However, we can point out some of the notable sectoral features of bilateral trade patterns over the past five years:

-- Annual two-way trade in computers, electronic components and telecom equipment crashed by 47 percent (US\$14 billion) over the past two years.

-- The acceleration in Canada's oil, gas and petroleum product exports to the United States contributed to the millennium "spike" by adding nearly US\$18 billion to our annual imports from Canada in 1999 and 2000. But unlike some other "boom" sectors, these flows have since held up well: they continued growing into 2001 and declined only modestly in 2002.

-- Passenger cars and trucks - the single biggest category in U.S.-Canada trade - has also held more or less steady. On the other hand, two-way trade in heavy trucks fell by 38 percent from 1999 to 2002.

PHARMACEUTICALS: A CLUE TO THE SCALE OF RE-IMPORTS

16. Among major categories of U.S. exports to Canada, the strongest percentage growth has been in pharmaceuticals. Over the past four years (2002 over 1998), Canada's imports of pharmaceuticals from the U.S. swelled by 65 percent. Imports of pharmaceuticals from all other countries grew by 125 percent. COMMENT: As Canadian authorities found with cross-border cigarette smuggling in the early 1990's, these figures may provide a sense of the extent to which U.S.-made products are being "cycled" through Canada and re-imported to U.S. consumers.

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